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No. ____

In the Supreme Court of the United States

THE BANK OF NEW YORK MELLON AND
THE BANK OF NEW YORK MELLON CORPORATION,
Petitioners,

v.

FREDERICK J. GREDE, AS TRUSTEE OF THE
SENTINEL LIQUIDATION TRUST,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

HECTOR GONZALEZ
MATTHEW D. INGBER
MAURICIO A. ESPAÑA
Mayer Brown LLP
1675 Broadway
New York, NY 10019
(212) 506-2500

JEFFREY W. SARLES
Counsel of Record
SEAN T. SCOTT
SEEMA V. DARGAR
Mayer Brown LLP
71 South Wacker Drive
Chicago, IL 60606
(312) 782-0600
jsarles@mayerbrown.com

Counsel for Petitioners

QUESTION PRESENTED

In *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), this Court held that a bankruptcy trustee lacked standing to file claims against a third party on behalf of a select group of creditors where any recovery would go only to those creditors rather than to the estate. In the decision below, the Seventh Circuit held that the *Caplin* rule does not apply where such claims were assigned to a liquidation trustee even though, as in *Caplin*, any recovery would go only to the assigning creditors rather than to the estate. The Seventh Circuit expressly recognized that its ruling conflicts with *Williams* v. *California 1st Bank*, 859 F.2d 664, 665-667 (9th Cir. 1988). The question presented is:

Whether a trustee appointed by a bankruptcy court to liquidate the estate has the authority to pursue assigned creditor claims against a third party where any recovery will not go to the estate.

RULE 29.6 STATEMENT

The Bank of New York Mellon Corporation is the parent corporation of The Bank of New York Mellon f/k/a The Bank of New York. No publicly held corporation owns 10% or more of the Bank of New York Mellon Corporation's stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners, The Bank of New York Mellon and The Bank of New York Mellon Corporation (collectively, "the Bank"), respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-8a) is reported at 598 F.3d 899. The district court's order (App., *infra*, 9a-25a) is reported at 409 B.R. 467.

JURISDICTION

The judgment of the court of appeals was entered on March 18, 2010. Petitioner's timely petition for rehearing en banc was denied on April 16, 2010. App., *infra*, 26a-27a. On July 7, 2010, the time within which to file this petition was extended by Justice Breyer to August 16, 2010. This Court's jurisdiction rests on 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

"The trustee in a case under this title is the representative of the estate." 11 U.S.C. § 323(a).

"The trustee shall *** collect and reduce to money the property of the estate for which such trustee serves ***." 11 U.S.C. § 704(a)(1).

STATEMENT

A. The Sentinel Bankruptcy

Sentinel was an investment manager that filed for Chapter 11 bankruptcy in August 2007. Respondent Frederick J. Grede ("Grede") was appointed trustee of the Sentinel estate in the Chapter 11 proceeding, in which Sentinel customers and other entities asserted unsecured claims. The Bank was Sentinel's only secured creditor.

In October 2007, Grede sued Sentinel's principals, alleging that they had defrauded Sentinel and its customers. In March 2008, Grede filed an adversary proceeding against the Bank, claiming that it had facilitated the Sentinel principals' alleged fraud. The district court granted the Bank's motion to dismiss the Trustee's claims in part. *Grede* v. *Bank of New York*, 2009 WL 188460 (N.D. Ill. Jan. 27, 2009). The remaining claims in that action are pending.

In December 2008, the bankruptcy court confirmed a Chapter 11 plan ("Plan") that established a Liquidation Trust to liquidate the Sentinel estate. C.A. App. 57.[1] The Plan also provided for Grede's resignation as Chapter 11 Trustee and his simultaneous appointment as Liquidation Trustee. *Id.* at 87 § 6.3. According to the Plan, Grede would thereby "become the appointed representative of the Estate in accordance with Section 1123(b)(3) of the Bankruptcy

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[1] "Although the central purpose of Chapter 11 is to facilitate reorganizations rather than liquidations (covered generally by Chapter 7), Chapter 11 expressly contemplates liquidations." *Florida Dept. of Revenue* v. *Piccadilly Cafeterias, Inc.*, 128 S. Ct. 2326, 2330 n.2 (2008) (citing 11 U.S.C. § 1129(a)(11)).

Code." *Ibid.* In the Bankruptcy Court's order confirming the Plan, Grede as Liquidation Trustee was given "all powers afforded a trustee under the Bankruptcy Code and Rules." *Id.* at 419 ¶ 4.

The Plan established "a distinct tranche of the Liquidation Trust," which it designated "Tranche-P," to hold the "Non-Estate Claims" of Sentinel customers who assigned those claims to the Liquidation Trust. C.A. App. 91 § 6.12. These Non-Estate Claims were defined broadly to include potential claims against numerous entities, including the Bank and "all Entities that entered into transactions with Sentinel." *Id.* at 74-75. The Plan authorized Grede to "prosecute, settle, and release the Non-Estate Claims" (*id.* at 89 § 6.5(c)), specifying that Sentinel creditors who did not hold claims assigned to Tranche-P "will not receive any distribution on account of Tranche-P." *Id.* at 91 § 6.12. Many but not all of the Sentinel customer claims were assigned to Tranche-P.

The Plan also established a "Liquidation Trust Expense Fund" from which Grede and his retained professionals are to be compensated. C.A. App. 91-92 § 6.14, 94 § 6.21. The Liquidation Trust Agreement provides that Grede shall receive both "hourly-based compensation" and "contingency-based compensation" tied to recoveries obtained for the Liquidation Trust. *Id.* at 148.

B. District Court Proceedings

In April 2009, Grede brought this action on behalf of Sentinel customers who had assigned their claims against the Bank to Tranche-P. C.A. App. 7 ¶ 5. He raised essentially the same claims that he had raised previously against the Bank, but now on

behalf of only the assigning customers, with any recovery to go only to the assignors, not to the estate. *Id.* at 43-50 ¶¶ 148-68.[2]

The Bank moved to dismiss this action, contending that Grede lacks standing and that his claims are insufficient as a matter of law. The district court granted the Bank's motion, holding that Grede lacks standing and not reaching the Bank's additional grounds for dismissal.

District Judge Zagel explained that a precedent of this Court bars standing where a bankruptcy trustee pursues claims for money not owed to the estate. App., *infra*, 16a, citing *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972). The court refused Grede's request to create an exception where the trustee is an assignee of such claims because "he is still subject to the Code's requirement that he act for the benefit of the estate." *Id.* at 19a. Moreover, the court reasoned, allowing a trustee to pursue such non-estate litigation risks diminishing the assets available to the estate's creditors. *Ibid.* As the court put it, bankruptcy law does not permit a trustee "to bring claims for the benefit of the few at the expense of the many." *Ibid.* Allowing Grede's claims to proceed would "essentially circumvent[] the order of priority of claims established by the Code" by distributing the proceeds solely to some holders of unsecured claims. *Id.* at 22a. For these and other reasons, the court concluded, "the estate has no interest in the claims, and Trustee has no authority under the Code to bring them." *Id.* at 21a-22a.

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[2] Pursuant to Rule 14(g)(ii), petitioner notes that respondent asserted diversity jurisdiction in the district court pursuant to 28 U.S.C. § 1332(a)(1).

C. The Court of Appeals' Decision

The Seventh Circuit reversed. It ruled that *Caplin* does not apply to a suit "by a liquidation trustee on assigned claims," likening the trust established to liquidate the estate to "a reorganized debtor." App., *infra*, 5a-6a.

The court of appeals rejected the Bank's contention that authorizing liquidation trustees to use estate assets to finance assigned litigation that will not benefit the estate creates a perverse incentive to free-ride off the estate in conflict with bankruptcy law principles. According to the panel, the Bank has no interest in avoiding such a harmful consequence. *Id.* at 7a.

The Seventh Circuit expressly recognized that its ruling conflicts with *Williams* v. *California 1st Bank*, 859 F.2d 664, 665-667 (9th Cir. 1988), opting instead for a contrary ruling in *Semi-Tech Litig., LLC* v. *Bankers Trust Co.*, 272 F. Supp. 2d 319, 323-324 (S.D.N.Y. 2003), aff'd, 450 F.3d 121 (2d Cir. 2006). The panel stated that "[w]e must choose between the second circuit's holding and the ninth's," and it chose the former. App., *infra*, 5a.[3]

REASONS FOR GRANTING THE PETITION

Grede was appointed Chapter 11 Trustee and then Liquidation Trustee for a specific purpose—to gather the Sentinel estate assets for distribution to Sentinel creditors in accordance with applicable

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[3] Although this Court used the term "standing" in *Caplin*, the Seventh Circuit expressed a preference for the term "authority" to avoid any confusion with Article III standing, which is not at issue in this case. App., *infra*, 3a. This petition uses the two terms interchangeably.

Bankruptcy Code provisions. He filed this lawsuit for a very different purpose—to obtain damages for a subset of Sentinel's unsecured creditors on their personal claims against the Bank. Far from maximizing the value of the estate, this lawsuit forces the estate to subsidize litigation that does not even purport to seek any benefit for the estate as a whole. Accordingly, Grede lacks authority to bring this lawsuit, and the Seventh Circuit's ruling should be vacated to ensure that bankruptcy estates are not used to bankroll litigation in which they have no interest.

The Seventh Circuit's ruling conflicts with *Caplin*, in which this Court held that a bankruptcy-court-appointed trustee lacks authority to pursue recoveries for select creditors rather than for the estate as a whole. The Seventh Circuit erred by allowing Grede to circumvent *Caplin* by means of a formalistic change of hats. As this Court said in *Caplin*, expanding a trustee's litigation authority is up to Congress, not the courts.

The decision below also conflicts with *Williams* v. *California 1st Bank*, 859 F.2d 664, 665-667 (9th Cir. 1988), as the Seventh Circuit expressly recognized. In *Williams*, the Ninth Circuit held that a liquidation trustee lacked authority to pursue assigned claims where any recoveries would go only to the assignor-creditors, not to the estate. Whereas the Ninth Circuit found the claims' assignment to the trustee an insufficient distinction from *Caplin* to require a different result, the Seventh Circuit agreed with the Second Circuit's view that such an assignment authorizes a trustee to pursue claims that, under *Caplin*, otherwise would be unauthorized. There is now a mature, three-way acknowledged conflict among the circuits.

The issue presented is one of exceptional importance. The longstanding rule that trustee litigation must seek to benefit the estate protects against free riding. The Seventh Circuit's abrogation of that rule when select creditor claims are assigned to a liquidation trustee will encourage wholesale assignments of such claims to liquidation trustees to enable the assignors to avoid the costs of litigation and instead foist them on the estate. The bankruptcy process was not designed for such an improper purpose. The need for clarity on this subject is critical for the proper administration of the soaring number of bankruptcy filings, especially in complex cases.[4]

I. THE RULING BELOW CONFLICTS WITH THIS COURT'S *CAPLIN* PRECEDENT AND THE PLAIN MEANING OF THE BANKRUPTCY CODE.

In *Caplin*, a "trustee in reorganization" appointed under Chapter X of the former Bankruptcy Act brought suit "for the benefit of a specific class of creditors, the debenture holders," against an indenture trustee charged with ensuring the sufficiency of the debtor's assets. 406 U.S. at 416, 421 n.12. The Court evaluated whether the trustee had standing by first looking to the statutory provisions governing the trustee's authority, where it found "nothing" that "enables him to collect money not owed to the es-

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[4] See *Bankruptcy Filings Highest Since 2006*, News Release, Administrative Office of the U.S. Courts (May 14, 2010), http://www.uscourts.gov/news/NewsView/10-05-14/Bankruptcy_Filings_Highest_Since_2006.aspx (bankruptcy filings rose 27% in last 12 months); Sara Murray, *Personal Bankruptcies Rise*, Wall St. J., Aug. 5, 2010, at A2.

tate." *Id.* at 428. Instead, under the plain language of the Act the trustee's task was "simply to 'collect and reduce to money the property of the estates.'" *Id.* at 428-429. Thus, a bankruptcy trustee lacked statutory authority to sue third parties for recoveries that would not go to the estate.

The Court then noted additional problems with such trustee suits: they would likely raise issues of subrogation, may be inconsistent with any independent actions brought by the affected creditors, and would not be as binding on all such creditors as a class action. 406 U.S. at 430-432 & n.22. The Court recognized that it would not necessarily be "unwise" to allow the trustee to bring such suits. *Id.* at 434. But it concluded that conferring standing on a trustee for such matters is "a policy decision [that] must be left to Congress and not to the judiciary." *Ibid.*

Congress responded to that invitation, when it replaced the Bankruptcy Act with the Bankruptcy Code in 1978, by considering and rejecting a proposal to broaden trustee litigation authority. The House bill included a proposed Section 544(c) which would have "overrule[d] *Caplin*" by authorizing both reorganization and liquidation trustees to sue for recoveries that would go only to select creditors "on whose rights the trustee has based the action." H.R. Rep. No. 95-595, at 370-371 (1977), 1978 U.S.C.C.A.N. 5963, 6326. That provision was dropped in conference. "The inability of the drafters of the Code to square the proposed § 544(c) with Rule 23 of the Federal Rules of Civil Procedure and the complex issues arising in class action situations led to a decision to delete the proposed subsection." Patrick A. Murphy & Eric E. Sagerman, CREDITORS' RIGHTS IN BANKRUPTCY § 13.7 (2d ed. 2009).

As a result, trustees were left with no greater litigation authority under the new Code than under the former Act. 124 Cong. Rec. H11,097 (Sept. 28, 1978); see *In re Ozark Restaurant Equip. Co.*, 816 F.2d 1222, 1227-1228 & n.9 (8th Cir. 1987) (describing history and applying the *Caplin* rule to Chapter 7 liquidation trustees). As numerous courts have recognized, Congress's affirmative rejection of this attempt to overrule *Caplin* maintained the enforceability of the *Caplin* rule on trustee standing under the new Code. *E.g.*, *DSQ Property Co.* v. *DeLorean*, 891 F.2d 128, 131 (6th Cir. 1989) ("The Bankruptcy Act still has no provision providing for a bankruptcy trustee to sue third parties on behalf of creditors"); *E.F. Hutton & Co.* v. *Hadley*, 901 F.2d 979, 986 (11th Cir. 1990) (*Caplin* "remain[s] the law under the revised bankruptcy statutes"); *In re Bradley*, 326 F. App'x 838, 839 (5th Cir. 2009). It is improper for courts to effect a change in the law that Congress specifically rejected. "Congress is presumed to be aware of [a] judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change." *Forest Grove Sch. Dist.* v. *T.A.*, 129 S. Ct. 2484, 2492 (2009). That is especially true where, as here, the judicial change increases the likelihood of vexatious litigation. See *Stoneridge Inv. Partners* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 162-163 (2008).

The Bankruptcy Code limits the scope of a trustee's authority to serving the estate. A trustee appointed by a bankruptcy court is "the representative of the estate" (11 U.S.C. § 323(a)), who shall "collect and reduce to money the property of the estate for which such trustee serves." *Id.* § 704(a) (made applicable to Chapter 11 proceedings by *id.* § 1106(a)(1)). See *CFTC* v. *Weintraub*, 471 U.S. 343, 352 (1985) (a

trustee "has the duty to maximize the value of the estate"); *Ohio* v. *Kovacs*, 469 U.S. 274, 284 n.12 (1985) (a trustee is "charged with the duty of collecting and reducing the property of the estate"). "Property of the estate" is defined as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a). A trustee's duty to gather that property for the benefit of the estate cannot be reconciled with the initiation of private litigation on behalf of select creditors.

Caplin established a bright-line rule essential to the administration of the many complex bankruptcy cases facing federal courts. If any recovery would go to the estate, the trustee has authority to bring suit. *E.g.*, *In re Bogdan*, 414 F.3d 507, 514 (4th Cir. 2005). If any recovery would go only to assigning creditors rather than to the estate, the trustee does not have such authority. *E.g.*, *E.F. Hutton*, 901 F.2d at 986; *Ozark Restaurant*, 816 F.2d at 1229-1230.

That rule holds true even outside the ordinary bankruptcy context. Thus, in *Boston Trading Group* v. *Burnazos*, 835 F.2d 1504, 1514 (1st Cir. 1987) (Breyer, J.), the court held that a receiver appointed by a federal court to pursue claims on behalf of defunct commodity investment firms lacked standing to pursue claims on behalf of individual investors in the firms' commodity pools. Then-Judge Breyer explained that there was "no relevant distinction between *Caplin* and the case before us," requiring the First Circuit "to follow the Supreme Court case." *Id.* at 1515-1516. Accord *Marion* v. *TDI Inc.*, 591 F.3d 137, 148 (3d Cir. 2010); *Fleming* v. *Lind-Waldock & Co.*, 922 F.2d 20, 25 (1st Cir. 1990); see also *Florida Dept. of Ins.* v. *Chase Bank of Tex. Nat'l Ass'n*, 274 F.3d 924, 929-931 (5th Cir. 2001) (applying *Caplin* to

deny liquidator of insolvent insurer standing to pursue policyholders' claims).

The Seventh Circuit, too, should have followed *Caplin*. It is undisputed that any recovery from this lawsuit will go not to the estate for pro rata distribution to the creditors but instead only to a subset of Sentinel's unsecured creditors. App., *infra*, 11a. Moreover, Grede's fees and expenses incurred in prosecuting this lawsuit will be paid out of estate assets. C.A. App. 91-92 § 6.14. Thus, this litigation not only will not benefit the estate but also will affirmatively harm it. Accordingly, as the district court correctly ruled, Grede lacks authority to bring this action. [5]

The Seventh Circuit thought this case distinguishable from *Caplin* on the ground that Grede brought claims assigned to a liquidation trust established by a confirmed Chapter 11 plan, likening the trust to a reorganized debtor "just like the reorganized United Airlines." App., *infra*, 6a. But unlike a reorganized debtor, the Liquidation Trust is not a going concern that emerged from bankruptcy ready to stand on its own feet. It was not established to generate additional assets and revenues or incur additional liabilities as part of its post-emergence operations. Neither Grede nor anyone else contributed any new capital or financing to allow the debtor to

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[5] As Professor Dan Schechter commented after the decision below issued: "The result in this case seems to circumvent the decision by Congress in 1978 to ratify *Caplin*." Dan Schechter, *Liquidation Trustee is Empowered to Assert Claims Assigned by Estate's Creditors Against Third Party Tortfeasors*, Commercial Finance Newsletter (Apr. 5, 2010), available on Westlaw at 2010 COMFINNL 28.

"emerge" from bankruptcy. The trust is not a rehabilitated "business" in the ordinary meaning of that term but simply a mechanism to liquidate the estate, *i.e.*, gather the estate's assets for pro rata distribution to the estate's creditors. This conclusion is confirmed by the IRS regulations governing liquidation trusts established by Chapter 11 plans:

> An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose. A liquidating trust is treated as a trust for purposes of the Internal Revenue Code because it is formed with the objective of liquidating particular assets and *not as an organization having as its purpose the carrying on of a profit-making business.*

26 C.F.R. § 301.7701-4(d) (emphasis added).

Moreover, the Plan makes clear that establishment of the Trust would not expand Grede's authority beyond those he held as Chapter 11 Trustee. The estate was to remain in place, and Grede's task was to liquidate it according to Code priorities. Specifically, the Plan established the Liquidation Trustee as "representative of the Estate *in accordance with Section 1123(b)(3) of the Bankruptcy Code.*" C.A. App. 87 § 6.3 (emphasis added). Section 1123(b)(3) authorizes a trustee to enforce only claims or interests "belonging to the debtor or to the estate." Further, after confirmation "the Chapter 11 Case will remain open pending final order of the Bankruptcy Court closing the case and the Bankruptcy Court shall retain jurisdiction" for numerous listed purposes, including

"[t]o determine on a non-exclusive basis, any and all Causes of Action and Non-Estate Claims that have been transferred to the Liquidation Trust on the Transfer Date." C.A. App. 104 § 9.1(b). Similarly, the Confirmation Order provides that the Liquidation Trustee will have "all powers afforded a trustee under the Bankruptcy Code and Rules" (C.A. App. 419 ¶ 4), underscoring that Grede's powers are coextensive with those of a bankruptcy trustee.

In sum, the Plan by its terms did not reorganize the debtor and free it from Bankruptcy Court oversight; it simply established a vehicle to liquidate the estate with the same trustee at the wheel. Both before and after confirmation of the Plan, Grede's authority was limited to marshaling the debtor's assets for the benefit of the estate. See *Holywell Corp.* v. *Smith*, 503 U.S. 47, 52-53 (1992) (noting that the duties of a person appointed to liquidate a debtor pursuant to a confirmed plan do not differ whether he is characterized as a "trustee in a case under title 11," "receiver," or "assignee"). Yet, the Seventh Circuit seized on Grede's redesignation from Chapter 11 Trustee to Liquidation Trustee to expand his litigation authority, contrary to the command of *Caplin*. See *Torch Liquidating Trust* v. *Stockstill*, 2008 WL 696233, at *6 n.4 (E.D. La. Mar. 13, 2008) ("prior case law is explicit that Litigation Trusts such as Plaintiff do not have standing to pursue the direct claims of creditors"), aff'd on alternate grounds, 561 F.3d 377 (5th Cir. 2009).

The Seventh Circuit's reliance on a formalistic distinction between pre- and post-plan liquidation trustees would allow the *Caplin* rule—and the statutory provisions on which its rests—to be circumvented by simply giving the trustee a new name or

label, which would empower him broadly to pursue private claims at the expense of the bankruptcy estate. The petition should be granted to ensure that this Court's precedents are not cast aside based on artificial distinctions.

II. THE RULING BELOW DEEPENS A CIRCUIT SPLIT OVER TRUSTEE STANDING TO BRING ASSIGNED CLAIMS THAT WILL NOT BENEFIT THE ESTATE.

As the Seventh Circuit expressly recognized, its ruling in this case conflicts with that of the Ninth Circuit in *Williams* v. *California 1st Bank*, 859 F.2d 664 (9th Cir. 1988). App., *infra*, 5a.

In *Williams*, over 100 investors in a Ponzi scheme initiated by the debtor assigned their claims against a bank that allegedly facilitated the scheme to a Chapter 7 liquidation trustee. Noting that "*Caplin* and its progeny control this case," the Ninth Circuit ruled that the trustee lacked standing to pursue those claims. 859 F.2d at 666-667. The court rejected the notion that "the mere fact of assignment in order to allow the Trustee to pursue the claims for the creditors sufficiently distinguishes this case to allow of a different result." *Id.* at 666. The court explained that, notwithstanding the assignments, "the Trustee, as in *Caplin*, is attempting to 'collect money not owed to the estate.'" *Id.* at 667. The court concluded that "*no* trustee, whether a reorganization trustee as in *Caplin* or a liquidation trustee," may assert such claims, finding support in "Congress' express decision not to overrule *Caplin*." *Ibid.* (emphasis added).

The Seventh Circuit rejected the *Williams* decision in favor of *Semi-Tech Litig., LLC* v. *Bankers*

Trust Co., 272 F. Supp. 2d 319 (S.D.N.Y. 2003), aff'd, 450 F.3d 121 (2d Cir. 2006). The district court in *Semi-Tech* disagreed with *Williams* on the ground that a trustee-assignee is "no different" from any other assignee "outside the bankruptcy context." *Id.* at 323-324. The Second Circuit affirmed, adopting the district court's opinion "as the law of this Circuit." 450 F.3d at 123. Courts in the Second Circuit continue to maintain that *Caplin* does not limit a trustee's standing to pursue assigned claims even where any recoveries will go only to the assignors and not to the estate. See *Taberna Capital Mgmt., LLC* v. *Jaggi*, 2010 WL 1424002, at *3 (S.D.N.Y. Apr. 9, 2010).

In contrast, other courts have followed *Williams* and held that "[t]he rule articulated in *Caplin* holds true even in cases where a creditor has assigned her claims to a trustee or Trust." *Trenwick Am. Litig. Trust* v. *Ernst & Young, L.L.P.*, 906 A.2d 168, 191 (Del. Ch. 2006), aff'd sub nom. *Trenwick Am. Litig. Trust* v. *Billett*, 931 A.2d 438 (Del. 2007); accord *Mukamal* v. *Bakes*, 383 B.R. 798, 811-814 (S.D. Fla. 2007) (post-confirmation liquidation trustee lacked standing to pursue assigned claims), aff'd on other grounds, 2010 WL 1731775 (11th Cir. Apr. 30, 2010).

This Court should grant the petition to resolve this conflict on the recurring issue whether the simple assignment of claims to a trustee obviates the *Caplin* rule on trustee standing. The conflict should be resolved against an "assignment" exception to *Caplin*. As Professor Schechter has observed: "If *Caplin* can be circumvented by the simple expedient of executing an assignment, then it is limited to a very strange set of facts, *i.e.*, when a trustee tries to assert claims belonging to creditors who do not con-

sent to his behavior." Dan Schechter, *Where Creditors Have Executed Formal Assignments of Tort Claims, Liquidation Trustee as Assignee Has Standing to Prosecute Creditors' Claims*, Commercial Finance Newsletter (Apr. 26, 2010), available on Westlaw at 2010 COMFINNL 33.

The Seventh Circuit suggested that there is something anomalous about barring a liquidation trustee, but not the rest of the world's potential assignees, from bringing a suit like this. App., *infra*, 4a. But a trustee appointed by a bankruptcy court to represent the estate is very different from the universe of other potential assignees. He is a creature of bankruptcy law with powers limited by statute, and no assignee other than the Trustee can force the bankruptcy estate to subsidize such litigation. Indeed, if the customer claims had been assigned to Grede in his personal capacity, he (or the assignors) would have had to incur the upfront costs of litigation, just like other plaintiffs. It is Grede's unique power as Bankruptcy-Court-appointed trustee to impose those costs directly on the estate that distinguishes him from all other potential assignees.[6]

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[6] In the court of appeals, Grede argued that *Sprint Commc'ns Co.* v. *APCC Servs., Inc.*, 554 U.S. 269 (2008), limits *Caplin* and overrules *Williams*. But *Sprint* does not address the litigation authority of a bankruptcy-court-appointed trustee, holding only that an assignee's standing to sue is not barred simply because any proceeds will go to the assignors. That point of assignment law is immaterial here. Whether the proceeds go to the assignors or stay with the assignee, they will not go to the estate, an issue of bankruptcy law governed by *Caplin* and not addressed by *Sprint*.

III. THIS COURT SHOULD RESOLVE THIS IMPORTANT FEDERAL QUESTION TO PREVENT SUBSTANTIAL HARM TO THE BANKRUPTCY PROCESS.

The Seventh Circuit's ruling threatens severe adverse practical consequences for numerous bankruptcy cases pending in the federal judicial system. Unless reversed, it will generate perverse (and irresistible) incentives by allowing trustees to use the estates they are supposed to represent to finance litigation against third parties on behalf of assigning creditors. Whereas litigation costs generally act to constrain private parties from pursuing unwarranted litigation, the Seventh Circuit's ruling allows a trustee to draw freely on estate assets to pursue third-party litigation. Especially where, as here, a trustee is not only guaranteed his fees and expenses from estate assets but also has a chance to earn a substantial contingency fee if he wins, even the most dutiful of trustees would be hard-pressed to resist being overly litigious. As Judge Posner has noted, courts must "be vigilant in policing the litigation judgment exercised by trustees." *Maxwell* v. *KPMG LLP*, 520 F.3d 713, 718 (7th Cir. 2008). That is particularly true with respect to litigation launched by liquidation trustees with personal incentives to bring actions funded by the bankruptcy estate.

In the name of the Liquidation Trust, Grede has effectively set himself up as an independent plaintiffs' law firm, claiming the right to file lawsuits against third parties that will not benefit the estate (or the liquidation trust) but only select claimants. But unlike in other litigation, neither Grede nor his "clients" have to pay a dime in fees or expenses, all of which he imposes on the bankruptcy estate. If Grede

loses this lawsuit, he is still a winner because the estate will pay all his fees and expenses, as well as those of the professionals he engages to assist him. And if he wins this lawsuit, he stands to garner a hefty contingency fee as well. This is the sweetest of all possible deals, one that is unprecedented, unjustified, and open to abuse.

The ruling below invites wholesale assignments of personal claims to liquidation trustees so that claimants can foist the usual costs of litigation onto the bankruptcy estate, including on creditors with no interest in the resolution of those claims and nothing to gain from their pursuit. The Seventh Circuit said this is "no skin off *the Bank's* nose." App., *infra*, 7a. But the Bank is the very target of the assigned claims in this case, giving it an interest in ensuring that Sentinel's investors are subject to normal litigation constraints. Moreover, in other cases the Bank is bound to be among the estate creditors that could be forced to subsidize litigation from which the estate cannot benefit. There will doubtless be many such cases because post-confirmation liquidation trusts are becoming an increasingly popular tool for liquidating debtors via Chapter 11 plans. See David R. Kuney, *Liquidation Trusts and the Quagmire of Postconfirmation Jurisdiction: the Case of the Disappearing Estate*, 14 J. Bankr. L. & Prac. 6 Art. 3 (2005) (noting the "increasing use of the liquidating trusts" in confirmed bankruptcy plans); Andrew M. Thau *et al.*, *Postconfirmation Liquidation Vehicles (Including Liquidating Trusts and Postconfirmation Estates): An Overview*, 16 J. Bankr. L. & Prac. 2 Art. 4 (2007) (a liquidation trust "allows a Chapter 11 plan to be confirmed, and distributions to begin, before all of the debtor's assets have been liquidated or litigation completed, because often the most complex

and time-consuming matters are left for resolution by the [trust]").

This Court should review and reverse the decision below to prevent a misuse of the bankruptcy process for private gain at the expense of the estate as a whole—precisely what the bankruptcy laws were intended to prevent. See *Howard Delivery Serv., Inc.* v. *Zurich Am. Ins. Co.*, 547 U.S. 651, 667 (2006) (the "broad purpose" of the bankruptcy statutes "is to bring about an equitable distribution of the bankrupt's estate"). As the Court stressed in *Caplin*, if any change in the existing bright-line rule is to be made, that decision must come from Congress, which alone can address the competing policy issues. See also *Jones* v. *Harris Assocs. L.P.*, 130 S. Ct. 1418, 1430-1431 (2010) (change to longstanding "workable standard" is "a matter for Congress, not the courts").

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

HECTOR GONZALEZ
MATTHEW D. INGBER
MAURICIO A. ESPAÑA
Mayer Brown LLP
1675 Broadway
New York, NY 10019
(212) 506-2500

JEFFREY W. SARLES
Counsel of Record
SEAN T. SCOTT
SEEMA V. DARGAR
Mayer Brown LLP
71 South Wacker Drive
Chicago, IL 60606
(312) 782-0600
jsarles@mayerbrown.com

Counsel for Petitioners

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 09-3121

FREDERICK J. GREDE,
as Trustee of the Sentinel Liquidation Trust,
Plaintiff-Appellant,

v.

THE BANK OF NEW YORK MELLON and THE BANK OF NEW YORK MELLON CORPORATION,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 09 C 1919
James B. Zagel, *Judge*

Argued February 18, 2010.
Decided March 18, 2010.

Before EASTERBROOK, Chief Judge, and KANNE and ROVNER, Circuit Judges.

EASTERBROOK, Chief Judge.

After Sentinel Management Group, Inc., entered bankruptcy, the court appointed Frederick Grede as its trustee. A plan of reorganization under Chapter 11 of the Bankruptcy Code created a trust to hold most of Sentinel's assets (valued at more than $500 million) while its business was being wound up, its investments cashed out, and its claims paid. The plan was confirmed in December 2008. No one asked for a stay or appealed, and the plan took effect.

Grede changed hats from Chapter 11 Trustee to Trustee of the Sentinel Liquidation Trust.

Sentinel was a futures commission merchant and investment manager for commodity brokers, pension funds, and wealthy persons. Many of its customers (collectively the investors) believe that Sentinel defrauded them, and they blame not only Sentinel's managers but also The Bank of New York Mellon, which was Sentinel's clearing bank, lender, and depository for investment pools. Sentinel's claims against the Bank, including those seeking to recover payments that the Trustee characterizes as preferential transfers or fraudulent conveyances, were transferred to the Trust. Investors' claims against the Bank did not belong to Sentinel and were not part of the bankruptcy estate. But the terms of the Liquidation Trust permit investors to assign their claims to it for collection, and many of Sentinel's investors have done just that. The Trustee filed this action under the diversity jurisdiction to pursue the investors' claims.

The Bank made two threshold objections: first that the assignment was a collusive maneuver for the purpose of creating jurisdiction, which if so would knock out subject-matter jurisdiction, see 28 U.S.C. § 1359; and second that the Trustee lacks "standing" to pursue the investors' claims. We put "standing" in scare quotes because the usage is abnormal. A trustee owns the trust's assets. If these assets are depleted by fraud, the trustee may sue to redress the injury, even though the trust will distribute all of the proceeds to its beneficial owners. Indeed, a claim's assignee may sue even when the claim was assigned for the purpose of collection and there is no formal trust. See *Sprint Communications*

Co. v. APCC Services, Inc., 128 S. Ct. 2531 (2008). But in 1972 the Supreme Court used the phrase "lacks standing" to describe its conclusion that a bankruptcy trustee may not sue on behalf of investors who thought that a third party's acts had injured them and the debtor jointly. *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972). The Court used the language of "standing" to refer, not to injury, causation, and redressability, the three ingredients of standing, see *Steel Co. v. Citizens for a Better Environment*, 523 U.S. 83, 102-04 (1998), but to whether Congress had authorized a trustee to pursue a given kind of action. Whether a given action is within the scope of the Code is a question on the merits rather than one of justiciability. To avoid confusion, therefore, the rest of this opinion refers to the Trustee's "authority" to act on behalf of the investors, rather than his "standing" to do so.

A collusive assignment is a genuine jurisdictional problem. We treat an assignment as collusive when its sole function is to shift litigation from state to federal court. See, e.g., *Steele v. Hartford Fire Insurance Co.*, 788 F.2d 441, 444 (7th Cir. 1986); *Hartford Accident & Indemnity Co. v. Sullivan*, 846 F.2d 377, 382 (7th Cir. 1988).

Assignment to a trust could be designed to take advantage of the rule that a trust's citizenship is that of the trustee, rather than the beneficiaries, for the purpose of 28 U.S.C. § 1332(a). See *Navarro Savings Association v. Lee*, 446 U.S. 458 (1980). Cf. *Northern Trust Co. v. Bunge Corp.*, 899 F.2d 591 (7th Cir. 1990) (a non-trustee holder of injured parties' claims has the same citizenship as the claims' owners). But it would not be sensible to put the assign-

ments to the Sentinel Liquidation Trust in the collusive category.

The Bank is a citizen of New York; many investors are not, and many individual claims exceed $75,000, so those investors could sue under the diversity jurisdiction in their own names. Or one investor could sue on behalf of a class; only the plaintiff's citizenship would count, just as only a trustee's citizenship counts. See *Snyder v. Harris*, 394 U.S. 332, 340 (1969). What's more, the Trust already is suing the Bank in federal court in its capacity as holder of Sentinel's claims to recover preferential or fraudulent transfers; the investors' claims could be added under the supplemental jurisdiction. See 28 U.S.C. § 1367; *Exxon Mobil Corp. v. Allapattah Services, Inc.*, 545 U.S. 546 (2005). The assignments thus do not move litigation from state to federal court; instead they facilitate efficient aggregation of claims, just as Fed. R. Civ. P. 23 does. Subject-matter jurisdiction is secure.

The district court dismissed the suit after concluding that the Trustee lacks authority to act on behalf of the investors. 409 B.R. 467 (N.D. Ill. 2009). It relied on *Caplin* and one circuit's conclusion that *Caplin's* rule applies even after the bankruptcy ends. *Williams v. California 1st Bank*, 859 F.2d 664 (9th Cir. 1988). The Trustee observes that this approach makes him the only one of the world's 6.8 billion people who cannot sue on assignments of the investors' claims; the Bank replies that the problem is not that Grede used to be a trustee in bankruptcy, but that the Trust holds assets that came from Sentinel's estate. According to the Bank, the Trust may use its assets to subsidize suit on the assigned claims; if the Trust loses, its beneficial owners will be out of pock-

et. The Bank submits that, in order to protect the Trust's beneficial owners, the Trustee should be forbidden to champion third-party claims. At least one circuit has rejected that argument, and the *Williams* decision, in holding that a liquidating trust created in bankruptcy may accept and sue on assignments of third-party claims. *Semi-Tech Litigation, LLC v. Bankers Trust Co.*, 272 F. Supp. 2d 319, 323-24 (S.D.N.Y. 2003), affirmed & adopted, 450 F.3d 121, 123 (2d Cir. 2006). We must choose between the second circuit's holding and the ninth's.

Caplin gave three reasons for its conclusion that a bankruptcy trustee may not pursue third-party claims. First, the Bankruptcy Act of 1898 elaborately specified the powers of trustees in bankruptcy; none of its provisions so much as hinted that bankruptcy judges could transfer third-party claims to trustees. 406 U.S. at 428-29. (Six years after *Caplin*, the Bankruptcy Code of 1978 replaced the Bankruptcy Act of 1898. The parties agree that the Code does not make any change material to the issue in *Caplin*.) Second, the third-party claims in *Caplin* might have created a right of subrogation, which would have required the debtor in bankruptcy to reimburse the third-party defendant for anything the trustee collected on behalf of the investors. The Court did not see any benefit in such a roundabout process. 406 U.S. at 429-31. Third, permitting a bankruptcy trustee to pursue third-party claims creates a risk of inconsistent or double recovery-because the claims had been placed in the trustee's hands by the judge rather than by the claims' owners. 406 U.S. at 431-34. None of these reasons applies to suit by a liquidation trustee on assigned claims.

Although the terms of the Bankruptcy Code govern the permissible duties of a trustee *in* bankruptcy, the terms of the plan of reorganization (and of the trust instrument) govern the permissible duties of a trustee *after* bankruptcy. A liquidation trust is no different in this respect from a reorganized debtor. No one believes that the powers and duties of the managers at United Airlines, which emerged from bankruptcy when the court approved its plan of reorganization in 2006, depend today on the terms of the Code. They depend on the terms of the plan, on United's articles of incorporation, and on rules of corporate rather than bankruptcy law. People are tempted to assume that bankruptcy is forever and that the Code continues to regulate the conduct of former debtors. We have held otherwise. See *In re Zurn*, 290 F.3d 861 (7th Cir. 2002); *Pettibone Corp. v. Easley*, 935 F.2d 120 (7th Cir. 1991). The Sentinel Liquidation Trust is a post-bankruptcy vehicle, just like the reorganized United Airlines. (That the bankruptcy proceeding continues after the plan's approval does not affect this conclusion; proceedings after the plan is confirmed often are necessary to value particular claims and distribute proceeds, but this process is independent of the reorganized entity's current operations.)

So much for *Caplin's* first reason. The Bank does not seriously contend that a right of subrogation would enable it to make any claim against Sentinel's assets; the Bank would have had to make such an argument in the bankruptcy court, and it did not. Today the Bank's rights against the Trust are limited by the plan of reorganization. As for *Caplin's* third reason: the Trust holds only those third-party claims that investors have assigned, so there is no possibility of inconsistent dispositions or duplicative

recoveries. By proceeding on the investors' voluntary assignments rather than a bankruptcy judge's directive, Sentinel's plan of reorganization cures *Caplin's* third problem.

The Bank cites *Caplin* often but in the end does not rely on any of its three reasons. As we've mentioned, the Bank's principal argument is that the Trust should not be allowed to deplete its assets by the expense of litigating the investors' claims. If the Trust pursues these claims and loses, legal fees and other expenses are out the window, for the investors assigned their claims without promising to underwrite the Trust's litigation. Yet this is no skin off *the Bank's* nose. The Bank is not among the Trust's beneficial owners-and, if it were, the time to object would have been when the plan of reorganization was proposed. The possibility that the Trust would use some of its assets to sue on behalf of the assignors was apparent to any reader of the plan or the trust documents. Any beneficial owner could have objected and demanded that the assignors contribute not only their claims but also liquid assets. No one objected on this ground, however, and the plan, having taken effect, is not open to the sort of collateral attack that the Bank now wages. *In re UNR Industries, Inc.*, 20 F.3d 766 (7th Cir. 1994); *In re Harvey*, 213 F.3d 318, 321 (7th Cir. 2000).

The Bank is trying to fend off the Trust's claims not by standing on its own rights, but by asserting that the litigation might injure strangers (the Trust's beneficiaries). It is a basic principle that litigants can't invoke the rights of third parties. American law recognizes a few instances in which *jus tertii* claims ("third-party standing") are allowed, but these are rare. See *Kowalski v. Tesmer*, 543 U.S. 125 (2004)

(discussing authority); cf. *MainStreet Organization of Realtors v. Calumet City*, 505 F.3d 742 (7th Cir. 2007) (discussing prudential limits when third parties suffer the principal injury). The Bank does not even try to show that it meets the requirements for third-party standing, let alone for the sort of third-party claim that would justify a belated challenge to a confirmed plan of reorganization.

Although the Bank tries to recast this argument as one about Delaware trust law (the Trust is a business trust under Delaware law), this line of argument does more to show *Caplin's* irrelevance than to escape from the problem that the Bank is asserting strangers' supposed entitlements. For if the Trust's ability to accept and sue on the assigned claims really does depend on Delaware law, then *Caplin*, which rests on federal bankruptcy law, does not have a role to play. We need not get into this subject, however, because the Trust's beneficial owners, rather than the Bank, are the right persons to make any contention that the Trust should not have accepted the assignments of the investors' choses in action.

We conclude that *Caplin* does not apply to the activities of a liquidating trust created by a plan of reorganization (or, for that matter, an ex-debtor operating under a confirmed plan). The judgment of the district court is reversed, and the case is remanded for further proceedings consistent with this opinion.

APPENDIX B

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

FREDERICK J. GREDE, not individually but as Liquidation Trustee of the Sentinel Liquidation Trust, Assignee of certain claims,

Plaintiff,

v.

THE BANK OF NEW YORK MELLON and THE BANK OF NEW YORK MELLON CORP.,

Defendants.

No. 09 C 1919.

July 28, 2009.

MEMORANDUM OPINION AND ORDER

JAMES B. ZAGEL, District Judge.

I. BACKGROUND

Plaintiff, Liquidation Trustee as Assignee of certain creditor claims, brings this action against Defendants alleging that they aided and abetted debtor investment manager's breach of fiduciary duty to its customers, aided and abetted debtor's fraud, and acted negligently toward debtor's customers. Defendants now move to dismiss the complaint for lack of standing, pursuant to Federal Rule of Civil Procedure 12(b)(1), and for failure to state a claim under Rule 12(b)(6). For the following reasons, Defendants' motion is granted.

II. STATEMENT OF RELEVANT FACTS

Plaintiff in this case is the Liquidation Trustee of the Sentinel Liquidation Trust. Sentinel was an investment manager for sophisticated clients, including commodity brokers, hedge and pension funds, and financial institutions. Sentinel was a Bank of New York ("BNY") customer, initially as a client of its custodial services group and then as a client of its clearing services division. Trustee alleges that Sentinel insiders engaged in a fraudulent scheme to leverage customer assets, putting the company and the customers at risk if the market were to decline. This is exactly what happened, and in August 2007, Sentinel collapsed and filed for bankruptcy. Trustee alleges that Defendants knew of and participated in this scheme by establishing an account structure that facilitated the commingling of assets that should have been segregated and the misuse of customer funds. In early 2008, Trustee filed an adversary action against Defendants on the basis of their alleged misconduct, seeking to recover for the Liquidation Trust the value of the customer assets that he alleges were improperly desegrated and used as leverage. See *Grede v. Bank of New York*, No. 08 C 2582, 2009 WL 188460 (N.D. Ill. 2009). In 2009, Trustee filed another action against Defendants, this time as assignee of certain of Sentinel's customers' claims, seeking to recover the millions lost by these customers. Because Plaintiff's allegations in this case (the "customer action") are substantially similar to those asserted in the initial action against Defendants (the "Trustee action"), I see no need to restate them in great detail and refer the reader to the Trustee action for a more comprehensive factual background with regard to debtor Sentinel's business and the al-

leged misconduct by Defendants. *Id.* I will, however, address a few facts relevant to this case specifically.

On December 15, 2008, the bankruptcy court entered an order confirming the Fourth Amended Chapter 11 Plan of Liquidation for Sentinel (the "Plan"). Trustee, formerly the Chapter 11 trustee for Sentinel, became the Liquidation Trustee for the Sentinel Liquidation Trust (the "Trust"), which represents Sentinel's estate. As part of the Plan, claims held by Sentinel's customers who accepted the Plan were transferred to the Liquidation Trust, and the Trust became the assignee of the claims. The Plan established a distinct tranche of the Trust to hold the non-estate customer claims assigned to the Trust. Claims held in this tranche do not become property of the estate, and non-assignors of claims are entitled to no distributions from this special tranche. It is the assigned customer claims that Trustee now asserts against Defendants.[1] Defendants move to dismiss Trustee's complaint for lack of standing, pursuant to Federal Rule of Civil Procedure 12(b)(1), and for failure to state a claim under Rule 12(b)(6). Because Trustee does not have standing to bring the assigned claims, I need not reach the issue of the sufficiency of the complaint.

III. DISCUSSION

A. Whether Defendants' Standing Challenge is Barred by Res Judicata

The first issue I must address is Trustee's contention that res judicata bars BNY's standing chal-

[1] Trustee asserts the claims of customers who accepted the Plan together with those of certain additional customers who did not accept the Plan.

lenge. Because the assignments at issue were made pursuant to Sentinel's chapter 11 liquidation plan-a plan approved by the bankruptcy court-Trustee maintains that Defendants are now launching "a collateral attack on the power of the Bankruptcy Court to effect an assignment of the claims by approving the Plan." *Semi-Tech Litig., LLC v. Bankers Trust Co.*, 272 F. Supp. 2d 319, 324 (S.D.N.Y. 2003). I am not persuaded by this argument and find that res judicata does not bar BNY's standing challenge.

"To apply res judicata, three essential elements must exist: (1) a final judgment on the merits in an earlier action; (2) an identity of the cause of action in both the earlier and later suit; and (3) an identity of parties or privies in the two suits." *Wade v. Hopper* 993 F.2d 1246, 1252 (7th Cir. 1993). "The doctrine of res judicata bars suit on matters which were raised or could have been raised in previous litigation between the parties." *Matter of Vitreous Steel Products Co.*, 911 F.2d 1223, 1234 (7th Cir. 1990). According to Trustee, Defendants have litigated their objections to the confirmation of the Plan. Although they did not challenge Trustee's standing to bring the assigned claims, they did challenge the assignments on other grounds. It was during that proceeding, Trustee argues, that the standing challenge should have been made.

This argument is problematic for two reasons. First, it appears that Defendants' objections to the plan were never ruled on, since the parties settled their dispute with regard to the Plan. Next, Trustee's contention that Defendants essentially waived their standing objection is unavailing. Standing, a jurisdictional question, cannot be waived. *Wiggins v. Martin*, 150 F.3d 671, 673 (7th Cir. 1998). While "[i]t is a

well-established principle of bankruptcy law that a party with adequate notice of a bankruptcy proceeding cannot ordinarily attack a confirmed plan," *In re Harvey*, 213 F.3d 318, 321 (7th Cir. 2000) (citing 11 U.S.C. § 1327(a)), confirmation of a bankruptcy plan "is res judicata only as to issues that can be raised in the less formal procedure for contested matters[.]" *Strong v. IRS* (*In re Strong*), 203 B.R. 105, 114 (Bankr. N.D. Ill. 1996) (holding that "confirmation generally cannot have preclusive effect as to the validity of a lien, which must be resolved in an adversary proceeding as mandated by Fed. R. Bankr. P. 7001(2)."). "[A] confirmed plan acts more or less like a court-approved contract or consent decree that binds both the debtor and all the creditors." *In re Harvey*, 213 F.3d 318, 321 (7th Cir. 2000). But proceedings to recover money are adversarial under the Federal Rule of Bankruptcy Procedure 7001(1) and are more formal than contested matters. *In re Matter of Beard*, 112 B.R. 951, 955 (Bankr. N.D. Ind. 1990). Adversarial matters are initiated by a summons and complaint, to which defendants are expected to respond. *Id.* Contested matters are typically dealt with by motion and a response is generally not necessary. *Id.* "If an adversary proceeding is required to resolve the disputed rights of third parties, the potential defendant has the right to expect that the proper procedures will be followed." *Id.* It is difficult to see how the issue of standing in this adversarial action could have been litigated as part of the less-formal confirmation process before the adversarial action itself was even filed.

In support of his argument, Trustee relies on *Semi-Tech*, where the plaintiff, an entity created by a

liquidation plan, brought claims assigned by debtor's creditors against a third-party defendant.[2] The defendant challenged the plaintiff's standing generally to assert such claims and also challenged the validity of the Bankruptcy Court's assignment of the claims. The court found that the attack on the validity of the assignments was a collateral one on the power of the bankruptcy court, barred by res judicata, but addressed the general standing challenge on the merits. In this case, Defendants are not claiming that assignments pursuant to the liquidation plan are invalid, only that Trustee has no standing to bring the assigned claims. Similar to *Semi-Tech*, the standing issue before me must be addressed on the merits.

B. Standing

Defendants argue that the Trustee lacks standing to bring this suit because the individual claims at issue here belong to third-party creditors and are non-estate claims. Federal bankruptcy law "places a trustee in the shoes of the bankrupt corporation and affords the trustee standing to assert any claims that

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[2] Trustee also relies on *In re J. Allan Steel Company*, 323 B.R. 425, 433 (Bankr. W.D. Pa. 2005) for the proposition that Defendants should have raised their standing challenge during the confirmation stage. In that case, the court held that the defendant's standing challenge to creditors' committee's adversarial action, authorized by the Bankruptcy Court, was barred by res judicata because the defendant "had ample opportunity at the confirmation hearing to object to the provision of debtor's plan delegating the power to bring avoidance actions to the Committee[,]" but failed to do so. *Id.* However, the court points to no case law in support of its conclusion that the issue of standing in a future adversarial proceeding should be decided at the time of a bankruptcy plan's confirmation hearing. I respectfully decline to follow the court's reasoning in that case.

the corporation could have instituted prior to filing its petition for bankruptcy." *In re CBI Holding Co., Inc.*, 529 F.3d 432, 454 (2d Cir. 2008). The claims presented here are, according to the Amended Complaint, "the direct claims of certain of Sentinel's customers." In other words, Sentinel's customers are seeking recovery for harms BNY allegedly caused them, not Sentinel itself. Defendants maintain that because these claims involve monies owed not to the estate, but to the customers directly, the Trustee has no authority, and thus no standing, to bring this suit on their behalf.

Trustee makes essentially two arguments in support of his contention that he does indeed have standing to bring the assigned customer claims. First, according to Trustee, the fact that the claims at issue were assigned to the Liquidation Trust under the Plan approved by the bankruptcy court makes all the difference. He argues that as assignee, he is stepping directly into the shoes of the assignors and should not be treated any differently from any other assignee. Second, Trustee argues that where any recovery would not go directly to particular assignors but would be shared by them pro rata, the Trustee is the real party in interest, and should not be barred from bringing the assigned actions.

"[A] litigant seeking relief in federal court must satisfy both constitutional and prudential limitations in order to have standing to sue." *Locals 666 and 780 of Intern. Alliance of Theatrical Stage Employees and Moving Picture Mach. Operators of United States and Canada, AFL-CIO v. U.S. Dept. of Labor*, 760 F.2d 141, 143 (7th Cir. 1985). "The prudential limitations on standing are those imposed by the courts themselves[.]" *Id.* "One well-established prudential-

standing limitation is the principle that a litigant cannot sue in federal court to enforce the rights of third parties." *Rawoof v. Texor Petroleum Co., Inc.*, 521 F.3d 750, 757 (7th Cir. 2008). "When a third party has injured not the bankrupt corporation itself but a creditor of that corporation, the trustee in bankruptcy cannot bring suit against the third party. He has no interest in the suit." *Steinberg v. Buczynski*, 40 F.3d 890, 893 (7th Cir. 1994).

The liquidation trustee is specifically authorized to "collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(1). "Property of the estate" under § 541(a) has "uniformly been interpreted to include causes of action." *Polis v. Getaways, Inc. (In re Polis)*, 217 F.3d 899, 901 (7th Cir. 2000). The United States Bankruptcy Code (the "Code"), from where a trustee derives his powers, does not authorize a trustee to "collect money not owed to the estate." *Caplin v. Marine Midland Grace Trust Co. of New York*, 406 U.S. 416, 428 (1972). In *Caplin*, the Court held that a Chapter X Trustee did not have standing to bring, on behalf of debtor's debenture holders, claims against a third party. The Court's decision was informed by three factors: (1) the Code does not authorize a trustee "to collect money not owed to the estate"; (2) it was unclear whether, where debtor and third party may have been *in pari delicto*, the third party would be entitled to be subrogated to the claims of the debenture holders; and (3) the possibility that the trustee's action would produce outcome inconsistent with any independent actions the debenture holders might themselves bring. *Id.* at 427-435. Because granting the trustee standing would have increased litigation "or

at least complicated" it, the Court declined to do so. *Id.* at 434.

Trustee first argues that this case is distinguishable from *Caplin* since the claims at issue in this case were assigned to the liquidation Trust under the Plan approved by the Bankruptcy Court. He argues that as assignee, he is stepping directly into the shoes of the assignors, and that his statutory authority is not implicated. Trustee relies on *Sprint Communications Company v. APCC Services, Inc.*, a case that did not involve a bankruptcy trustee, where the Supreme Court recognized that "an assignee can sue based on his assignor's injuries," and "federal courts routinely entertain suits which will result in relief for parties that are not themselves directly bringing suit." 128 S. Ct. 2531, 2542, 2543 (2008). Under *Sprint*, he argues, the fact that only those customers who assigned their claims will benefit from any recovery in this case is no reason to deny standing. 128 S. Ct. at 2543 (reasoning "[w]hat does it matter what the [assignors] do with the money afterward? The injuries would be redressed whether the [assignors] remit the litigation proceeds to the [customers], donate them to charity, or use them to build new corporate headquarters."). According to Trustee, he should not be treated any differently from any other assignee.

This argument is unpersuasive in light of case law involving powers of trustees. In *Williams v. California 1st Bank*, 859 F.2d 664, 666 (9th Cir. 1988),[3]

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[3] Trustee relies on *Semi-Tech Litigation, LLC v. Bankers Trust Company*, where the court found *Williams* unpersuasive and saw "no basis for treating an assignee created by, or assignments made pursuant to, a Chapter 11 plan any differently"

the Court held that the same concerns that militated against standing in *Caplin* bar a liquidation trustee from suing third parties on behalf of estate creditors even where the creditor claims are assigned to the trustee. The Court in *Williams* addressed the Trustee's authority to bring assigned creditor claims. There, the creditor-assignors were to receive the bulk of any recovery, with only administrative costs from a favorable judgment going to the estate. The Court determined that the creditors, not the estate, were the "real party in interest." *Williams*, 859 F.2d at 666. Because the trustee in that case was "attempting to collect money not owed to the estate[,]" he did not have the authority under the Code to bring the creditor claims, notwithstanding the assignment. *Id.* at 666-67. In discussing the benefits of court-approved assignment of creditor claims, the Court in *In re CBI Holding* remarked that "[a]llowing a deb-

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from an assignee or assignment created outside the bankruptcy context. 272 F. Supp. 2d 319, 324 (S.D.N.Y. 2003). In that case, the court considered neither the priority of claims nor the issue of subrogation, discussed *infra* — issues significant to this case. For this reason I am not persuaded by the court's analysis in *Semi-Tech*, and rely instead on the reasoning in *Williams*. Furthermore, in *Semi-Tech*, the court did not discuss how any recovery would be distributed, another significant matter here. In *In re CBI Holding Co., Inc.*, 529 F.3d at 459, the Second Circuit discussed *Semi-Tech's* holding "that a trustee may assert claims assigned to it by a bankrupt's creditors *for the benefit of the estate*, because those claims *can become property of the estate* under § 541(a)(7)." This suggests that the trustee must continue to act pursuant to his authority under the Code, even where he is the assignee of creditors' claims. However, in this case, the Plan explicitly states that the assigned non-estate claims shall not become property of the estate. In this way, the case before me is distinguishable from *Semi-Tech*, and the notion articulated therein that trustee assignees should not be treated any differently from non-trustee assignees does not apply here.

tor's creditors to assign their claims *for the benefit of the debtor's estate* permits debtors, creditors, and bankruptcy courts the flexibility in reorganizing or liquidating a debtor's assets necessary to achieve efficient administration of the reorganization or liquidation." 529 F.3d at 549 (emphasis added); *see also Logan v. JKV Real Estate Servs. (In re Bogdan)*, 414 F.3d 507, 512-513 (4th Cir. 2005) (holding that trustee may bring assigned creditor claims where estate is the real party in interest). Even where a trustee brings assigned claims, he is still subject to the Code's requirement that he act for the benefit of the estate.

Policy also suggests that Trustee should be treated differently from a non-trustee assignee. "As a creature of statute, the trustee in bankruptcy has only those powers conferred upon him by the Bankruptcy Code." *In re Cannon*, 277 F.3d 838, 853 (6th Cir. 2002) (citation omitted). Trustee in this case brings the assigned claims as Trustee, not in his personal capacity. As Trustee, the estate pays his legal fees and costs. Failure to prevail on his claim would diminish the assets available to creditors of the estate. It is for this reason Trustee should be limited to his powers under the Code. Trustee should not be permitted to bring claims for the benefit of the few at the expense of the many.[4]

Trustee next argues that *Williams* does not apply here since the proceeds of the assigned claims will be distributed in accordance with a court-approved

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[4] It is true that Trustee has also filed a claim against BNY on behalf of the estate, however, discovery would not be entirely duplicative and would in this action be the source of extra expense.

bankruptcy plan. In support of this position, Trustee cites *In re CBI Holding Company, Inc.*, 529 F.3d at 458, where the Court recognized a trustee's ability to bring assigned creditor actions against third parties. "We can think of many arguments against allowing a trustee to usurp the claims of a bankrupt's non-cooperating creditors that do not counsel against permitting creditors to voluntarily transfer their claims to a trustee as part of a court-approved plan of reorganization or liquidation." *Id.*[5] According to Trustee, where any recovery would not go directly to particular assignors but would be shared by them pro rata, the Trustee is the real party in interest, and *Williams* does not apply.

Trustee's analysis misses the mark. In order for the estate to be the real party in interest, any recovery must come into the estate to then be distributed according to the order of priority prescribed by the Code. In *In re Bogdan*, the court expressly distinguished the case before it from *Williams*, explaining that

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[5] The language in *In re CBI Holding* is not difficult to construe. What does it mean to say "We can think of many arguments against [usurping] that do not counsel [against assignment]"? One thing that is not said is that "all arguments against usurping do not counsel against assignment." This excerpt from *CBI* is in the language of dicta, not of holding. And it is the language of dicta because the panel understood the key issue was whether the "adverse interest" exception (allowing a trustee to step out of the "shoes" of the failed company) applied in light of the facts found by the Bankruptcy Judge. Besides the fact the language is dicta, it is not intended to be read as a thorough analysis of the proposition it mentions. It is, I noted, incomplete as a statement that trustees can sue as assignees of individual creditors. Dicta can be persuasive but the court did not intend to persuade, or it would have said more.

> Unlike the investors in *Williams*, the [assignors] in this case will recover, if at all, by sharing from the general assets of the estate on a pro rata basis *with all other creditors*. So, unlike the trustee in *Williams*, Bogdan's trustee is seeking to collect money it claims the alleged coconspirators owe the trustee as assignee and *representative of the estate*, not money owed to specific creditors. Accordingly, Bogdan's estate is the real party in interest in this adversary proceeding.

In re Bogdan, 414 F.3d at 513 (emphasis added). In *Bogdan*, the fact that any recovery would go to the estate, from which the assignors, like all other creditors, would recover on a pro rata basis, meant that the trustee was bringing action to collect money owed to the estate for the benefit of all of the creditors. The court in *Steinberg v. Kendig (In re Ben Franklin Retail Stores, Inc.)*, 225 B.R. 646, 651 (Bankr. N.D. Ill. 1998) drew a similar distinction, noting that there, "the estates are the real parties in interest, and any proceeds will come into the estates, to be distributed in accordance with the bankruptcy code."

In this case, under the Plan, recovery on the assigned claims would be pooled together into a special tranche of the Trust and "distributed to the assignors in accordance with the priorities established by the Plan." It is true that the tranche is part of the Trust, however non-assignors may not recover from the tranche. This structure excludes a significant intermediary link in the chain of recovery-that the proceeds come "into the estate," to be distributed pro rata among assignors and non-assignors alike. Without this link, the estate has no interest in the claims,

and Trustee has no authority under the Code to bring them. One goal of the Bankruptcy Code is to ensure equal distribution among creditors, allowing for preferential treatment of certain creditors pursuant only to congressional authorization. *Howard Delivery Service, Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 655 (2006) (citations omitted). Under 11 U.S.C. § 725, priority and secured claims are to be paid before any distributions are made to unsecured creditors. If any funds remain after priority claims are paid, then unsecured creditors may receive a distribution. *Monarch Air Service v. Solow (In re Midway Airlines, Inc.)*, 383 F.3d 663, 669 (7th Cir. 2004). In this case, Sentinel customers are unsecured creditors. So although under the recovery structure put forth here, the assignors must divide any proceeds pro rata among themselves, they are essentially circumventing the order of priority of claims established by the Code. For this reason, it is crucial that the estate be the real party in interest, and that the Trustee not be allowed to do by virtue of assignment what he may not do on his own.

Further militating against Trustee's standing here is the possibility of subrogation. In *Williams* the court addressed the issue of whether, where the debtor and Defendant are *in pari delicto*, Defendant would be able to subrogate itself to the assignors' position and recoup any recovery to which assignors may be entitled. 859 F.2d at 667. The Court held that where such a possibility exists, there would be little advantage in giving trustee standing to sue. *Id.* at 667 (citing *Caplin*, 406 U.S. at 430). While the defense of *in pari delicto* has been raised by BNY against the Trustee, the issue has not yet been decided, neither has the validity of BNY's lien upon Sentinel's assets. But, as the Supreme Court noted in

Caplin, regardless of whether subrogation is appropriate here,

> the fact remains that in every reorganization there is going to be a question of how much the trustee in reorganization should be permitted to recover on behalf of the debenture holders. The answer is, of course, whatever he cannot recoup from the corporation.... In other words, debenture holders will not be able to recover damages from the indenture trustee until the reorganization is far enough along so that a reasonable approximation can be made as to the extent of their losses, if any.

406 U.S. at 430-431. The Court reasoned that the creditors should therefore represent their own interests and decide for themselves whether or not it would be "worthwhile" to seek recovery on any losses. It is true that the assignments in this case reflect the creditors' decision as to whether to proceed with their claims, but the Court's point is well taken — we do not know at this time what the customers' damages, unsatisfied by the bankruptcy proceeding, will be. Moreover, with subrogation as a possibility, "it is as difficult here as it was in *Caplin* to see what advantage there is in giving the trustee standing to sue." *Williams*, 859 F.2d at 667.

Trustee maintains that, "[t]aken to its logical extension, BNY's argument would mean that the customers could have validly assigned their claims to anyone in the world except the liquidation trust." However, were the customers to assign their claims to someone else, or to pursue them on their own, the same considerations with regard to order of priority and subrogation would be implicated. In *Shatkin v.*

Bank of New York Mellon Corporation, 2008 WL 2446837, No. 07 Civ. 7928(PAC), at *2 (S.D.N.Y. June 17, 2008), one of the assignor/creditors involved in this action filed a putative class action against Defendants alleging the same misconduct asserted in the Trustee action against BNY. In its opinion staying the proceeding pending the outcome of the proceeding in Bankruptcy Court, the court in *Shatkin* noted that

> Plaintiff, putative class members, and BNY are parties to the bankruptcy proceeding; the Bankruptcy Court will determine whether BNY had a valid, first-priority security interest in and lien upon the assets at issue and how the remainder of Sentinel's assets are to be distributed; and, as a consequence of this proceeding, Plaintiff and the putative class members may be compensated for any injuries allegedly sustained.

Id. The reasons for the stay reflect several of the same concerns that informed the Court's decision in *Caplin*. While Trustee is correct that the customers could assign their claims to someone other than Trustee without being barred from pursuing the claims, that is not to say that the claims brought by another assignee would go forward uninhibited. The prudential limitations on a trustee's standing imposed in *Caplin* with regard to Trustee's standing apply here, notwithstanding the assignment of claims.[6] Indeed, if the Trustee could bring these

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[6] The court in *Caplin* pointed to the potential of inconsistent actions by the creditors on their own behalf as another reason to deny the trustee standing. Trustee argues that "It makes no sense to reject standing to one plaintiff because some other per-

claims, there would be good reason to stay proceedings on those claims as Judge Crotty stayed Shatkin's claims.

IV. CONCLUSION

For the foregoing reasons, Defendants' motion to dismiss is granted.

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son might have a claim against the same defendant." However, the Court was concerned with the inconsistency of the trustee's suits on behalf of a certain creditor with any independent action that same creditor would himself bring. 406 U.S. at 432. Judge Crotty's stay of the proceeding in *Shatkin* suggests some regard for such possible inconsistency, where Shatkin, a party to the bankruptcy proceeding and an assignor in this case, brought his own claim in a separate proceeding. It is not difficult to imagine the possibility of inconsistency with regard to these claims.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 09-3121

FREDERICK J. GREDE,
as Trustee of the Sentinel Liquidation Trust,
Plaintiff-Appellant,

v.

THE BANK OF NEW YORK MELLON and THE BANK OF NEW YORK MELLON CORPORATION,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 09 C 1919
James B. Zagel, *Judge*

April 16, 2010

Before
FRANK H. EASTERBROOK, *Chief Judge*
MICHAEL S. KANNE, *Circuit Judge*
ILANA DIAMOND ROVNER, *Circuit Judge*

Order

Defendants-appellees filed a petition for rehearing and rehearing en banc on April 1, 2010. No judge in regular active service has requested a vote on the

petition for rehearing en banc,* and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.

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* Judge Flaum did not participate in the consideration of this petition.